

BEFORE
THE PUBLIC SERVICE COMMISSION OF
SOUTH CAROLINA
DOCKET NO. 2004-357-W/S - ORDER NO. 2005-328

JUNE 22, 2005

IN RE:	Application of Carolina Water Service, Inc.)	ORDER APPROVING
	for Adjustment of Rates and Charges and)	RATES AND CHARGES
	Modification of Certain Terms and)	
	Conditions for the Provision of Water and)	
	Sewer Service)	

I. INTRODUCTION

This matter is before the Public Service Commission of South Carolina (“Commission”) on the Application of Carolina Water Service, Inc. (“CWS” or “Company”) for approval of a new schedule of rates and charges and modifications to certain terms and conditions for the provision of water and sewer services for its customers in South Carolina. CWS filed its Application on December 17, 2004, pursuant to S.C. Code Ann. § 58-5-240 (Supp. 2003) and 26 S.C. Code Ann. Regs. RR. 103-503 (1976), 103-703 (1976), 103-512.4.A (Supp. 2003) and 103-712.4.A (1976, as amended).

By correspondence, the Commission’s Docketing Department instructed CWS to publish a prepared Notice of Filing, one time, in a newspaper of general circulation in the area affected by CWS’s Application and to mail copies of the Notice of Filing to all customers affected by the proposed rates and charges and modifications. The Notice of Filing indicated the nature of the Application and advised all interested parties desiring to participate in the scheduled proceeding of the manner and time in which to file the

appropriate pleadings. CWS filed affidavits showing that it had complied with the Docketing Department's instructions.

Petitions to Intervene were subsequently filed on behalf of the South Carolina Department of Health and Environmental Control ("DHEC") and Midlands Utilities, Inc. ("Midlands"). The Commission received letters of protest from fifty-four (54) CWS customers. The South Carolina Office of Regulatory Staff ("ORS"), a party of record pursuant to S.C. Code Ann. § 58-4-10(B) (Supp. 2004), made on-site investigations of CWS' facilities, audited CWS' books and records, issued data requests, and gathered other detailed information concerning CWS' operations.

The Commission held four (4) separate public hearings in Dorchester, York and Lexington counties for the purpose of allowing CWS' customers to present their views regarding the Application.¹ A total of forty-nine (49) customers testified at these hearings.² Thereafter, on May 4, 2005, at 10:30 a.m., an evidentiary hearing was convened before the Commission in its offices in Columbia with the Honorable Randy Mitchell presiding. CWS was represented at the hearing by John M.S. Hoefer, Esquire. Charles H. Cook, Esquire, represented Midlands. Jessica J.O. King, Esquire represented DHEC. Florence P. Belser, Esquire, and Lessie C. Hammonds, Esquire, represented the ORS. Prior to the presentation of the cases of the parties of record, the Commission permitted nine (9) customers to testify, eight (8) of whom had not spoken at any of the

¹ These hearings were held April 18, 2005 in Summerville, April 20, 2005 in Irmo, April 26, 2005 in the Lake Wylie area of York County, and May 2, 2005 in the Oak Grove area of Lexington County. Pursuant to directions of the Commission's Docketing Department, notice of these hearings was given to affected customers by the Company as reflected in an affidavit filed by the Company.

² A total of 229 customers attended these hearings. It is reasonable to assume that more customers would have spoken but for the lateness of the hour and the desire to refrain from duplicative testimony.

previous public hearings. Fifteen (15) customers attended the May 4, 2005, hearing. CWS presented the direct and rebuttal testimony of three (3) witnesses: Bruce T. Haas, CWS Regional Director of Operations; Steven M. Lubertoizzi, CWS Director of Regulatory Accounting; and Pauline M. Ahern, CRRA, Vice-President of AUS Consultants – Utility Services. Midlands presented the direct and surrebuttal testimony of Keith G. Parnell. No testimony was presented by DHEC, although it made an offer of proof by way of a proffer of the pre-filed direct testimony of Jeffrey P. DeBessonnet, P.E.³ ORS presented the direct testimony of Willie J. Morgan, P.E., the Program Manager for its Water and Wastewater Department; Dawn M. Hipp, a Program Specialist in the ORS Water and Wastewater Department; and Sharon G. Scott, Auditor for ORS. Also, ORS presented the direct and surrebuttal testimony of Ben Johnson, PhD. of Ben Johnson Associates, Inc. The evidentiary hearing was completed on May 5, 2005.

In considering the Application of CWS, the Commission must consider competing interests to arrive at just and reasonable rates. These competing interests are those of the ratepayer and those of the utility, which has the right to earn a fair return. *S.C. Cable Television Ass'n v. Public Serv. Comm'n*, 313 S.C. 48, 437 S.E.2d 38 (1993). In so doing, we may consider the quality of the utility's service, which is determined by reference to its adequacy. *Patton v. S.C. Public Serv. Comm'n*, 280 S.C. 288, 312 S.E.2d 257 (1984). Regulation, as it has developed in the United States, is concerned with rates,

³ On April 25, 2005, CWS filed and served a motion seeking an order of the Commission prohibiting DHEC from introducing Mr. deBessonnet's prefiled testimony into evidence or making it part of the record in this case. By order of its duly appointed Hearing Officer, Charles L.A. Terreni, dated April 28, 2005, the Commission granted CWS's motion to the extent that it sought to preclude the reception of Mr. deBessonnet's testimony as evidence. However, Mr. Terreni's order permitted an offer of proof by DHEC. At hearing, CWS made a conditional offer of proof by way of a proffer of the rebuttal testimony pre-filed by Mr. Lubertoizzi in response to Mr. deBessonnet's testimony.

service, [and] safety. Charles F. Phillips, Jr., *The Regulation of Public Utilities*, (1993) at 171. Rate regulation has two aspects: control of the rate level (earnings) and control of the rate structure (prices). *Id.* As to the rate level, public utilities are entitled to cover all allowable operating costs and to have the opportunity to earn a “fair” rate of return. *Id.* Collectively, these items comprise a company’s total revenue requirements. *Id.* As to the rate structure, public utilities are permitted to establish rates that, at a minimum, will cover their revenue requirements. *Id.* at 171-72. Such rates must be “just and reasonable,” with no “undue” discrimination. *Id.* at 172.

Thus, in considering the Application of CWS, the Commission must give due consideration to the Company’s total revenue requirements, comprised of allowable operating costs and the opportunity to earn a fair rate of return. To this end, the Commission will review the operating revenues and operating expenses of CWS and will endeavor to establish adequate and reasonable levels of revenues and expenses. Further, the Commission will consider a fair rate of return for CWS based upon the record before it. Should the Commission’s determination show that rates should be increased, the Commission will then design rates that will meet the revenue requirements of CWS but that are also just and reasonable and free of undue discrimination.

II. PRELIMINARY MATTERS

A. THE CWS MOTION TO STRIKE

By written motion and supporting memorandum dated April 26, 2005, CWS moved the Commission for an order striking statements of certain customers made at hearings in this docket complaining of sewer backups. The Commission heard argument

on the motion by CWS prior to the start of its case in chief. [Tr. p. 86, l. 18 – p. 94, l. 13; Tr. p. 97, l. 5 – p. 106, l. 20.] None of the other parties of record opposed the Company's motion. [Tr. p. 94, ll. 14 – 16; p. 129, l. 16 – p. 130, l. 23.] The Commission reserved ruling on this motion and advised the parties that it would address it in its final order in this matter. [Tr. p. 130, l. 24 – p. 131, l. 3.]

CWS argues that the Commission lacks jurisdiction to consider such complaints in a rate setting proceeding brought pursuant to S.C. Code Ann. § 58-5-240. CWS takes the position that such complaints can only be heard in a complaint proceeding brought pursuant to S.C. Code Ann. § 58-5-270. CWS alleges that complaints regarding sewer backups are not an issue in the instant proceeding and consideration of consumer statements pertaining to same would constitute reversible error. CWS further states that consideration of such complaints as evidence in the present case denies CWS due process, and that the Commission lacks jurisdiction to address complaints alleging damages arising from acts or matters alleged to have been done or failed to have been done by the Applicant in the conduct of its business. For the following reasons, CWS' motion is denied.

This Commission lacks jurisdiction to award damages to customers as the result of the action or inaction of the Company. However, S.C. Code Ann. § 58-5-240(B) requires this Commission to "hold a public hearing concerning the lawfulness or reasonableness of the proposed changes [in rates]". Evidence pertaining to the company's quality of service, and specifically of sewer backups, is properly considered in light of this mandate.

The public testimony regarding sewer backup, though anecdotal, is relevant to our general review of customer service and the quality of service as provided by the Company. Also, the challenged testimony, and the greater body of customer testimony, is relevant to how the Company handles complaints. We would note that Commission Regulations 26 S.C. Code Ann. Regs. 103-516 and 103-716 (Supp. 2004) specifically address wastewater and water complaints, respectively. Customer complaints are of great concern to this Commission. In this Order, we are instituting certain measures that the Company must take to deal with the customer complaints and quality of service issues.

Furthermore, all parties were given the opportunity to cross examine the night hearing witnesses under oath, and were also allowed to present testimony rebutting their allegations. The Company filed rebuttal testimony responding to the specific episodes recounted by several public witnesses.⁴ In fact, we would note that Company witness Haas addressed these precise issues in testimony during the hearing in this case. [Tr., pp. 367-369.] We do not believe that the consideration of the evidence in the manner described denies the Company's due process rights. Accordingly, the Motion to Strike is denied.

B. THE STIPULATION BETWEEN CWS AND MIDLANDS

At the hearing, the Company and Midlands submitted a written stipulation and agreement that \$15 per single family equivalent is a reasonable monthly bulk sewer

⁴ CWS witness Haas testified, among other things that CWS has a policy of systematically cleaning its sewer lines in order to minimize backups and ruptures caused through intrusion by roots and other obstructions or breakage. Haas did not know if there were any industry standards for maintaining sewerage lines, and no other witness testified to the existence of such standards during the hearing. Tr. p. 357. Given CWS' avowed desire to minimize disruptions in its service, the Commission recommends that CWS determine whether such standards exist, and whether its maintenance program meets them.

service rate to be charged by CWS for treatment it provides for wastewater flow from Midlands' Vanarsdale subdivision service area. . [Tr. p. 71, l. 10 – p. 74, l. 17; Hearing Exhibit No. 7.] Currently, CWS treats 416 single family equivalents for Midlands. [Parnell Pre-filed Direct testimony, p. 2, ll. 20-21.] The current monthly rate of \$11 per single family equivalent was approved by this Commission in Docket No. 95-1151-S. ORS stated that it accepted the stipulation and agreement as being in the public interest. [Tr. P. 74, l. 23 – p. 75, l. 6.] DHEC did not take a position on the matter. [Tr. p. 74, ll. 18-19.]

We find that the stipulated rate is reasonable and therefore accept the stipulation and agreement. Under the stipulated rate, Midlands will experience an increase of approximately 36% in bulk treatment charges [Tr. p. 72, ll. 13-21], which is generally consistent with the amount of increase sought for the Company's other sewer customers (both treatment and collection only customers). [Lubertozzi Pre-filed Direct testimony, Tr. p. 290, l. 26 - p.291, l. 3.] Moreover, this rate is also only 23¢ more per month than a rate proposed by Midlands. [Parnell Pre-filed Direct testimony, p. 4, l. 11.] And, the rate established in Docket No. 95-1151-S has been in effect since 1996. [Parnell Pre-filed Direct testimony, p. 2, ll. 19-20.] The Company has since that time received approval for an increase in the rates of other customers from which Midlands was excepted. See Order No. 2001-887, August 27, 2001, Docket No. 2000-207-W/S. We find that acceptance of the stipulation is in the public interest because it reflects a resolution of a disputed issue in a matter within the jurisdiction of the Commission. *Cf.* S.C. Code Ann. § 58-4-50 (A)(9). And, as noted above, there has been no objection by the other parties

of record to this stipulation. Accordingly, in giving effect to the stipulation and agreement, consistent with our revenue findings herein, the Commission will include \$76,005 for bulk treatment services provided by the Company to Midlands in determining the total revenues in this proceeding.

III. FINDINGS OF FACT AND SUPPORTING EVIDENCE

1. CWS provides water service to approximately 5,800 customers and sewer service to approximately 10,000 customers in portions of Aiken, Beaufort, Charleston, Dorchester, Georgetown, Lexington, Orangeburg, Richland, Sumter, Williamsburg and York counties. As a public utility, its operations are subject to the jurisdiction of the Commission pursuant to S.C. Code Ann. §§ 58-5-10 *et seq.* (1976 & Supp. 2004).

The evidence supporting this finding is contained in the Company's application, the testimony of its witnesses Haas [Haas Pre-filed Direct testimony, Tr. p.322, ll. 18-20] and Lubertozi [Lubertozi Pre-filed Direct testimony, Tr. p. 288, ll. 12-17] and in the testimony of ORS witness Hipp [Hipp Pre-filed Direct testimony, Tr. p. 415 ll. 8-21.]

2. The appropriate test year for purposes of this proceeding is the twelve month period ending June 30, 2004.

The evidence supporting this finding is contained in the Company's application, the testimony of its witness Lubertozi [Lubertozi Pre-filed Direct testimony, Tr. p. 289, ll. 5-7], and the ORS Audit Department Report sponsored by ORS witness Scott [Scott Pre-filed Revised Direct testimony, Tr. p. 434, ll. 4-10 and 18; Hearing Exhibit No. 19 at 2, ¶ 3], which reflects that CWS proposed a test year ending June 30, 2004 and that ORS

accepted that as an appropriate test year. No other party objected to the proposed test year.

A fundamental principle of the ratemaking process is the establishment of a test year period. In *Heater of Seabrook v. Public Service Commission of South Carolina*, 324 S.C. 56, 478 S.E.2d 826 (1996), the Supreme Court observed that “[t]he ‘test year’ concept is very important in the rate-setting process. In order to determine what a utility’s expenses and revenues are for purposes of determining the reasonableness of a rate, one must select a ‘test year’ for the measurement of the expenses and revenues.” *Id.*, 478 S.E.2d 828, n. 1. The test year is established to provide a basis for making the most accurate forecast of the utility’s rate base, reserves, and expenses in the near future when the prescribed rates are in effect. *Porter v. South Carolina Pub. Serv. Comm’n*, 328 S.C. 222, 493 S.E.2d 92 (1997). The historical test year may be used as long as adjustments are made for any known and measurable out-of-period changes in expenses, revenues, and investments. *Id.* Accordingly, the Commission adopts the test year proposed by the Company and will make adjustments for any known and measurable changes outside the test year.

3. The Commission will use rate of return on rate base as a guide in determining just and reasonable rates.

The evidence supporting this finding is contained in the Company’s application and the testimony of its witness Lubertozzi. [Lubertozzi Direct Pre-filed testimony, Tr. p. 296, l. 25 – p. 297, l. 5.] Additionally, no other party of record proposed an alternative method for determining just and reasonable rates and the testimony of ORS’ witnesses

Scott and Johnson contemplate that return on rate base will be the methodology employed.

The Commission has wide latitude in selecting an appropriate rate-setting methodology. *Heater of Seabrook, supra*, 478 S.E.2d at 830. Even though S.C. Code Ann. § 58-5-240(H) (Supp. 2004) requires the Commission to specify an operating margin in all water and sewer cases, the Commission is not precluded by that statute from employing the return on rate base approach to ratemaking. *Id.* Operating margin “is less appropriate for utilities that have large rate bases and need to earn a rate of return sufficient to obtain the necessary debt and equity capital that a large utility needs for sound operation.” *Id.* In the Company’s last rate case, we employed the return on rate base methodology. The Company’s unadjusted rate base, according to its application, is \$15,639,930. Given the foregoing, and the uncontradicted testimony that the Company has a need to earn a fair and reasonable return on its investment, the Commission finds that the return on rate base methodology is the appropriate methodology to use in this case.

4. The determination of return on rate base requires consideration of three components, namely: capital structure, cost of equity (or return on equity) and the cost of debt.

The evidence supporting this finding is contained in the testimony of the Company’s and ORS’ expert witnesses on cost of capital. [Ahern Pre-filed Direct testimony, Tr. p. 136, ll. 3-9; Johnson Direct Pre-filed testimony, Tr. p. 228, l. 19 - p. 229, l. 9.]

5. In determining the Company's appropriate return on rate base, the correct capital structure and cost of debt is that of CWS' parent, Utilities, Inc., at December 31, 2003. Accordingly, for purposes of this proceeding, the correct capital structure is 59.23% (debt) and 40.77% (common equity) and the correct embedded cost of debt is 7.28%.

The evidence supporting this finding is contained in the testimonies of Company witness Ahern [Ahern Direct Pre-filed testimony, Tr. p. 136, ll. 5-8] and ORS witnesses Scott [Scott Revised Direct Pre-filed testimony, Tr. p. 434, ll. 6-10, Hearing Exhibit No. 19, pp. 4-5 and p. 22 and Johnson [Johnson Direct Pre-filed testimony, Tr. p. 228, l. 19 - p. 229, l. 17.] Use of the cost of debt of Utilities, Inc., verified by the ORS audit staff, is appropriate as CWS obtains all of its external financing from its parent, which determines how much income CWS can retain. This approach is also consistent with the analysis we employed in the Company's last rate case. [Id.]

6. A fair range of return on equity for CWS is 9.1% – 10.1%

The evidence supporting this finding is contained in the testimonies of Company witness Ahern and ORS witness Johnson. As noted by witness Ahern, under the standards enunciated in *Federal Power Commission v. Hope Natural Gas Co.*, 320 U.S. 591 (1944) and *Bluefield Water Works Improvement Co. v. Public Service Comm'n*, 262 U.S. 679 (1922), a utility is entitled to an opportunity to earn a fair rate of return. [Ahern Direct Pre-filed testimony, Tr. p. 138, ll. 1- 4.] The rate of return on common equity is a key figure used in calculating a utility's overall rate of return. *Porter v. South Carolina Public Service Commission*, 333 S.C. 12, 507 S.E.2d 328 (1998).

To determine the cost of equity, both Company witness Ahern and ORS witness Johnson employed the Comparable Earnings Model (“CEM”)⁴ and Discounted Cash Flow (“DCF”).⁵ In addition, Ahern also utilized the Capital Asset Pricing Model (“CAPM”) and the Risk Premium Model (“RPM”). Both DCF and CAPM are market-based approaches relying upon transactions in the securities markets and estimates of investor expectations. Charles F. Phillips, Jr., *The Regulation of Public Utilities* (1993) at 394.

Ahern assessed the market-based cost rates of similar risk companies, i.e. proxy groups, for insight into a recommended common equity cost rate for CWS. [Ahern Pre-filed Direct testimony, Tr. p. 140, ll. 5-6.] The proxy groups were used by Ahern because the Company’s common stock is not publicly traded, and, therefore, CWS’s market-based common equity cost rates cannot be determined directly. [Ahern Pre-filed Direct testimony, Tr. p. 137, l. 26 - p. 138, l. 10; p. 143, l. 15 - p. 145, l. 12.] Therefore, Ahern used two proxy groups of water companies whose common stocks were actively traded for insight into an appropriate common equity cost rate applicable to CWS. [Id.] The two proxy groups consist of six and three water companies, respectively. [Ahern Pre-filed Direct testimony, Tr. p. 144, Table 3.] Ahern selected the proxy group of six AUS Utility Reports water companies because (1) they were included in the Water Company Group of AUS Utility Reports (March 2005), (2) they have Value Line or Thomson FN/First Call Consensus projected growth rates in earnings per share, and (3) they have

⁴Johnson used the term “Comparable Earning Analysis” when referring to the CEM approach. For ease of reference, the Commission will refer to his “Comparable Earning Analysis” as CEA.

⁵Johnson used the term “market approach” when referring to his analysis which included DCF. For ease of reference, the Commission will refer to his “market approach” as DCF.

more than 70% of their 2003 operating revenues derived from water and sewer operations. [Ahern Pre-filed Direct testimony, Tr. p. 148, ll. 2-9.] The three Value Line water companies were chosen because they are included in the Water Utility Group of Value Line (Standard Edition) Water Utility Industry Group. [Ahern Pre-filed Direct testimony, Tr. p. 149, ll. 5-10.]

Ahern's DCF analysis yields cost rates for the proxy group of six AUS Utility Reports companies of 10.60% and for the proxy group of three Value Line water companies of 10.80%. [Ahern Pre-filed Direct testimony, Tr. p. 165, ll. 5-10.] The results of the RPM analysis produced common equity cost rates of 10.60% for the six AUS Utility Reports water companies and 10.80% for the proxy group of three Value Line water companies. [Ahern Pre-filed Direct testimony, Tr. p. 174, ll. 16-20.] The CEM produces common equity cost rate results of 14.50% for the proxy group of six AUS Utility Report water companies and 14.40% for the proxy group of three Value Line water companies. [Ahern Pre-filed Direct testimony, Tr. p. 189, ll. 9-11.] Finally, the traditional CAPM cost rate is 9.90% for the proxy group of six AUS Utility Reports water companies and 10.20% for the three Value Line water companies. The empirical CAPM cost rate is 10.40% for the proxy group of six AUS Utility Reports water companies and 10.60% for the proxy group of three Value Line water companies. The CAPM cost rate for the proxy group of six AUS Utility Reports water companies is 10.20% and for the three Value Line water companies is 10.40% based upon the traditional and empirical CAPM results. [Ahern Pre-filed Direct testimony, Tr. p. 180, l. 20 – p. 181, l. 6.] The average cost of common equity for the proxy group of six AUS

Utility Reports water companies is 10.9% and the average for the proxy group of three Value Line water companies is 11.0%.

Witness Ahern reviewed the results of the application of the four different cost of common equity models and then adjusted them upward to reflect CWS's greater risk compared to the proxy groups by adding an investment risk adjustment of .50% (50 basis points) to the average cost of equity of both proxy groups. This yielded Ahern's recommended range of common equity cost rates of 11.40% for the proxy group of six AUS Utility Reports water companies and 11.50% for the proxy group of three Value Line water companies. [Ahern Pre-filed Direct testimony, Tr. p. 137, ll. 1-26; p. 189, ll. 14-19.] In Ahern's opinion, the investment risk adjustment is necessary because CWS is a more risky investment than the average proxy group company due to CWS's small size compared to the two proxy groups, whether measured by book capitalization or the market capitalization of common equity. [Ahern Direct Pre-filed testimony, Tr. p. 191, l. 32 - p. 192, l. 4.] Ahern asserted that the loss of revenue from a few larger customers would have a greater effect on a small company than on a much larger company with a larger customer base. [Ahern Pre-filed Direct testimony, Tr. p. 143, l. 24 - p.144, l. 2.] Ahern then opined that, based upon the slightly greater financial risk of CWS *vis-a-vis* the nine proxy group companies [Ahern Direct Pre-filed Direct testimony, Tr. p. 147, ll. 10-16], CWS should be authorized a return on common equity at the higher end of her range, which is 11.50%. [Ahern Pre-filed Direct testimony, Tr. p. 193, ll. 19-20.]

Dr. Johnson's Comparable Earnings Analysis (CEA) is his equivalent of witness Ahern's Comparable Earnings Model (CEM). Dr. Johnson based his CEA on the earnings

on common equity of two broad and comprehensive groups: the Federal Trade Commission's "All Manufacturers" group and the group of approximately 900 companies monitored quarterly by Business Week. Using return-on-equity data from 1975 to 2004, Dr. Johnson calculated moving average returns for the five-year, ten-year, fifteen-year, twenty-year, and thirty-year periods for the Federal Trade Commission group and the Business Week group. [Johnson Pre-filed Direct testimony, Tr. p. 236, ll. 3-19.] Dr. Johnson concluded that the average current and near-future opportunity cost of equity capital for an unregulated firm is in the range of 11.5% to 13.0%. [Johnson Pre-filed Direct testimony, Tr. p. 238, ll. 3-6.] In the opinion of Dr. Johnson, the equity risk of the average regulated utility is far lower than the equity risk of the average unregulated firm, and the equity risk of water utilities is less than that of other utilities. [Johnson Pre-filed Direct testimony, Tr. p.238, ll. 20-23, p. 239, ll. 11-12.] Factoring in differences in overall equity risk separating unregulated industrial companies and regulated utilities, Johnson's CEA suggests a cost of equity of 10.0% to 11.5% for telephone utilities, electric utilities, and gas utilities and a cost of equity of 9.5% to 10.5% for water utilities. [Johnson Pre-filed Direct testimony, Tr. p. 242, ll. 11-23.]

Dr. Johnson's market DCF analysis used data for ten water companies for which Standard and Poor's stock reports were available. A proxy group was necessary because CWS does not issue common stock and its parent, Utilities, Inc., is not publicly traded. [Johnson Pre-filed Direct testimony, Tr. p. 244, ll. 8-10.] Based on his analyses of dividend yields and growth rates in dividends, earnings, and book values for the proxy group, Dr. Johnson concluded that investors in the proxy group companies require on

average a return on equity of approximately 8.5% to 9.8%. [Johnson Pre-filed Direct testimony, Tr. p.248, ll. 17-19.] Dr. Johnson added 0.4% to cover the cost of issuing stock and 0.6% to account for the relatively small size of CWS' service territory in South Carolina. After making these adjustments, Dr. Johnson concludes that his DCF analysis suggests a cost of equity of 9.5% to 10.8% as appropriate for CWS. [Johnson Pre-filed Direct testimony, Tr. p. 253, ll. 10 - p. 254, l. 1.]

For a number of reasons which will be discussed further, the Commission accepts the conclusions of ORS witness Dr. Johnson, with the exception of his 0.4% stock issuance adjustment. As noted above, Dr. Johnson states that CWS does not issue stock and its parent, Utilities, Inc., is not publicly traded. Therefore, no issuance of CWS has occurred in the recent past or will occur in the near future. Witness Ahern did not include a stock issuance adjustment stating that such an adjustment is only appropriate when a company is going to be issuing stock in the near term or has recently issued stock and needs to recover the cost of the issuance. CWS has not issued stock, nor does it plan to do so. [Tr. p. 217, l. 15 - p. 218, l. 2.] With no issuance of stock by CWS, no issuance adjustment is necessary. Thus, the 0.4% stock issuance adjustment of Dr. Johnson is not appropriate and should be removed from his recommended range of return on equity. Correcting for this inappropriate stock issuance adjustment results in a return-on-equity range of 9.1% to 10.7%.

Witness Ahern faults Dr. Johnson for relying exclusively on historical data for his CEA and DCF analyses. [Ahern Rebuttal testimony, Tr. p. 196, ll. 2-9.] Dr. Johnson states that the growth rate of 5.5% to 6.5% used in his analysis reflects the average

investor's long-run expectations for long-term dividend growth, not just the next few years. Value Line growth projections as used by witness Ahern represent what Value Line anticipates will occur in the next few years. [Johnson Surrebuttal testimony, Tr. p. 259, l. 22 - p. 261, l. 15., p. 262. ll. 1-14.]

Another criticism of Dr. Johnson's CEA analysis by witness Ahern is that his downward adjustment to the return on equity of unregulated industrial companies to reflect the lower equity risk of regulated companies lacks support. Dr. Johnson provides reasons for his risk adjustment. It is his belief that there is no data set that can directly measure the risk differential between regulated and unregulated companies. Therefore, Dr. Johnson relies on his judgment as to the appropriate magnitude of the risk adjustment. [Examination by Commissioner Howard, Tr. p.278, l. 15 - p. 281, l. 23.]

The Commission is of the opinion that the analyses and the resulting recommended return on equity of Company witness Pauline Ahern may overstate the appropriate return on equity for CWS. Witness Ahern eliminates all DCF results that are no more than 200 basis points above the current prospective average yield on A-rated public utility bonds. As a result, any return on equity below 8.6% is discarded. [Ahern Direct testimony, Tr. p. 165, l. 10 - p. 166, l. 7.] Ahern apparently assumes that investors expect the long-term yield on A-rated public utility bonds to be 6.6% and require a 200 basis point premium for return on equity.⁶ Also, based on Audit Exhibit SGS-1 Revised, the actual per books return on equity earned by CWS during the test year was 3.4%, well

⁶ The Commission notes that witness Ahern placed no such floor on her DCF analysis in her testimony in CWS Docket No. 2000-207-WS. Based on her testimony in Docket No. 2000-207-WS, a minimum DCF return on equity requirement of 200 basis points above the A-rated public utility bond yield would result in elimination of any return on equity below 9.9%. It appears that investors have reduced their expectations on the long-term yield of A-rated public utility bonds since the previous CWS rate case in 2001.

below the 8.6% minimum set by witness Ahern. [Audit Exhibit SGS-1, Revised, p.1, Hearing Exhibit 19] Thus, the return on equity actually earned by a company may fall below some preconceived floor. The low return-on-equity results may be discounted by the analyst when making recommendations, but should not be eliminated entirely from the analysis.

Witness Ahern also double counted the projected earnings per share (EPS) growth rates in her DCF analysis. In Ahern's Schedule PMA-9, Page 1 of 12, the Value Line and Thomson FN/First Call EPS growth rate projections are included individually and again as an average. [Hearing Exhibit 10.] When Commissioner Wright asked witness Ahern about the impact on her DCF results due to the double counting, witness Ahern stated that removing the projected growth rates and calculating return on equity using historical growth rates have little impact because calculated return on equity for all companies except Alta America would be eliminated as their return on equity would be below the floor based on the yield of A-rated public utility bonds. The DCF cost rates would be 12.5% for Alta America and between 5.6% and 6.7% for the other companies. [Examination by Commissioner Wright, Tr. p. 216, l. 5 - p. 217, l. 12.]

Having adopted the return-on-equity testimony of ORS witness Dr. Johnson with the removal of his inclusion of a 0.4% stock issuance adjustment, which the Commission has determined to be inappropriate, results in a return-on-equity range of 9.1% to 10.7%. The Commission determines a 1.0% range on return on equity is appropriate and concludes that a return-on-equity range of 9.1% to 10.1% is appropriate for CWS. The Commission notes that the Natural Gas Rate Stabilization Act signed by the Governor on

February 16, 2005, directs the Commission to specify a 1.0% cost of equity range for natural gas utilities regulated by this Commission. Also, the parties agreed to, and the Commission adopted, a 1.0% range for return on equity in the recent South Carolina Electric & Gas Company rate case in Order No. 2005-2, Docket No. 2004-178-E. Based on the December 31, 2003, capital structure of Utilities, Inc., a 7.28% embedded cost of debt, and a 9.1% to 10.1% cost of equity, the appropriate cost of capital for CWS is 8.02% to 8.43%. Rates are to be set at a 9.1% return on equity and an 8.02% cost of capital. We are setting rates at the low end of the range in order to minimize the impact on the Company's customers, while allowing the Company to realize a reasonable rate of return and maintain its financial viability.

7. Using the capital structure of Utilities, Inc. consisting of 59.23% debt and 40.77% common equity, a cost of debt of 7.28%, and a cost of equity of 9.1%, we conclude that an appropriate overall rate of return on rate base of 8.02% is appropriate and should be authorized for CWS. The evidence supporting this conclusion is found in the testimony of ORS witness Johnson. The following table indicates the capital structure of the Company, the cost of debt, the cost of equity as approved in this Order, and the resulting rate of return on rate base:

TABLE A

	RATIO	EMBEDDED COST	OVERALL COST
Long-term Debt	59.23%	7.28%	4.31%
Common Equity	<u>40.77%</u>	9.10%	<u>3.71%</u>
TOTAL	<u>100.00%</u>		<u>8.02%</u>

8. By its Application, CWS is seeking an increase in its rates and charges for water and sewer service which results in \$1,801,488 of additional revenues to CWS, net of uncollectible accounts.

The evidence for the finding concerning the amount of the requested rate increase is contained in the Application filed by CWS and in the testimony and exhibits of ORS witness Scott. The record reflects that this amount was calculated utilizing the billing units including customer growth included in the Company's Application [Revised Exhibits D and E] and as included by ORS in its original and revised Audit Report [Audit Exhibit SGS-1 and Revised Audit Exhibit SGS-1, Hearing Exhibit 19]. The Application of CWS indicates that it is seeking additional revenues of \$180,854 more than booked revenue from water operations and additional revenues of \$1,634,674 more than booked revenue from sewer operations which, after adjustment for uncollectible accounts, totals \$1,801,488. [Application, Exhibit B, Schedule B, p. 1 of 4.] Additionally, ORS witness Scott testified that under the rates proposed in the Application CWS would see an increase in revenues of \$1,801,488. [Scott Revised Direct Prefiled testimony, p. 436, ll. 3-4, Hearing Exhibit 19, p. 6.] However, ORS had made adjustments to booked revenue of \$15,618 to Water Revenue and \$14,247 to Sewer Revenue to reflect revenue as adjusted under present rates. [Testimony of Sharon G. Scott, p. 436, ll. 13-18.] These adjustments produce Water Revenue as adjusted under present rates of \$1,836,269 and Sewer Revenue as adjusted under present rates of \$3,774,328. [Application, Revised Schedule D, p. 1 of 2 (Water) and Application, Revised Schedule D, p. 2 of 2 (Sewer)]

and ORS Revised Exhibit DMH-5 under Test Year Revenue Overview (Water and Sewer), Hearing Exhibit 17.]

The Company is requesting an increase in rates and charges to produce annual revenues of \$2,001,504 for water operations and \$5,394,755 for sewer operations. [Application, Revised Schedule E, p. 1 of 2 (Water), Revised Schedule E, p. 2 of 2 (Sewer) and Schedule B, p. 1 of 4.]

The difference in Water Revenue of \$2,001,504 [Application, Revised Schedule E, p. 1 of 2] under proposed rates and \$1,836,269 [Application, Revised Schedule D, p. 1 of 2] as adjusted Water Revenue under present rates results in a requested increase in Water Revenue of \$165,235. The difference in Sewer Revenue of \$5,394,755 [Application, Revised Schedule E, p. 2 of 2] under proposed rates and \$3,774,328 [Application, Revised Schedule D, p. 2 of 2] as adjusted Sewer Revenue under present rates results in a requested increase in Sewer Revenue of \$1,620,427, or a combined Water and Sewer Revenue requested increase of \$1,785,662.

The Commission finds that the proposed increase in Sewer Revenues of \$1,620,427 should be further reduced by \$74,392 to reflect approval by the Commission of the adoption of the Stipulation and Agreement between CWS and Midlands Utility, Inc. The Stipulation and Agreement states that “CWS no longer seeks approval of a bulk sewer treatment service rate of \$29.68 to be charged to Midlands Utility per single family equivalent per month for bulk sewer treatment service to Midlands’ Vanarsdale Subdivision service area.” The proposed rate to be charged to Midlands Utility, Inc. for the Vanarsdale Subdivision of \$29.68 produced annual revenues of \$150,397.

[Application, Revised Exhibit E, p. 2 of 2.] The approved rate of \$15.00 per the Stipulation and Agreement between CWS and Midlands Utility, Inc. produces annual revenues of \$76,005, utilizing the same billing units of 5,067, for a decrease in annual revenues requested of \$74,392.

The Commission, therefore, finds that the proposed rates and charges, as amended for the adjustments above and for approval of the Stipulation and Agreement between CWS and Midlands Utility, Inc., produce additional gross annual sewer revenues of \$1,546,035, or a total requested increase in water and sewer rates and charges of \$1,711,270. These amounts are calculated by utilizing the billing units, including Customer Growth, as included in the Company's Application [Revised Schedules D and E] and as included by ORS in its original and revised Audit Report [Audit Exhibit SGS-1 and Revised Audit Exhibit SGS-1, Hearing Exhibit 19.]

9. The appropriate operating revenues for CWS for the test year under present rates and after accounting and pro forma adjustments are \$5,674,555.

The evidence supporting this finding is in the testimony of Company witness Lubertoizzi and ORS witness Scott. The application of CWS shows per book test year and as adjusted total operating revenues of \$5,644,689. [Application, Exhibit B, Schedule B, p. 1 of 4.] This amount included "Uncollectibles" of \$42,869 and miscellaneous revenues of \$106,827. [Id.] ORS adjusted test year operating revenues by \$29,865 based upon a bill frequency analysis it performed in connection with its audit, with water being adjusted by \$15,618 and sewer being adjusted by \$14,247. [Scott Pre-filed Revised Direct testimony, Tr. p. 436, ll. 13-18; Hearing Exh. No 19, p. 6, p. 9.]

ORS also included “Uncollectibles” of \$42,869 in the per books test year figures. [Id.] Thus, ORS computed as adjusted test year total operating revenues of \$5,674,555. Company witness Lubertozi agreed with the adjustment to operating revenues proposed by ORS. [Tr. p. 490, ll. 19-22; Tr. p. 491, ll. 10-14.] No other party presented any evidence pertaining to as adjusted test year total operating revenues. Therefore, the only evidence before the Commission on as adjusted total operating revenues is the \$5,674,555, and the Commission finds that to be the appropriate as adjusted test year total operating revenues.

10. The appropriate operating expenses for CWS for the test year under present rates and after accounting and pro forma adjustments and adjustments for known and measurable out-of test-year occurrences are \$5,276,647.

The evidence supporting this finding is contained in the Company’s application and in the testimonies of Company witness Lubertozi and ORS witness Scott. ORS offered certain adjustments to the Company’s proposed operating expenses for the test year which the Company accepted. [Scott Pre-filed Revised Direct testimony, Tr. p. 436, l. 19 - p. 443, l. 4, Tr. p. 447, l. 16 – p. 448, l. 4; Lubertozi Rebuttal Pre-filed testimony, Tr. p. 490, ll. 19-22; p. 491, ll. 10-14.] No other party of record offered testimony pertaining to the Company’s expenses or proposed adjustments thereto. These operating expenses and the adjustments agreed to by the Company and ORS which affect operating expenses, and the Commission’s determination as to each, are as follows:

(A) Operators' Salaries:

(1) Position of CWS: Initially, CWS proposed an adjustment to salaries of \$236,761, to be annualized as of June 30, 2004, to reflect salary and wages for six new operators and a manager to meet DHEC requirements for daily monitoring of water systems. At hearing, CWS agreed to the position of ORS on this adjustment, which proposed a total adjustment of \$141,365.

(2) Position of ORS: ORS adjusted to reflect only the four new operators hired and verified to CWS's payroll records and did not reflect the remaining three positions since they were not filled and therefore are not known and measurable. Although it accepted CWS's capitalization ratio, ORS reduced the amount of labor capitalized by \$3,969 to account for time spent by operators on capital projects. This resulted in a total adjustment of \$141,365 to salaries and wages.

(3) Decision of the Commission: Upon consideration of this expense item, the Commission adopts the adjustment agreed to by the Company and ORS.

(B) Consumer Price Index Adjustments

(1) Position of CWS: The Company initially proposed to increase certain maintenance and general expenses by 5.74% to reflect inflation utilizing the Consumer Price Index ("CPI") for Water and Sewerage Maintenance developed by the United States Department of Labor Bureau of Labor Statistics, the effect of which would have been to add \$84,311 to test year expenses. At hearing, CWS agreed with the position of ORS to disallow this adjustment.

(2) Position of ORS: In its Adjustment items numbers 3-9 and 13-17, ORS disagreed with the Company's proposal to adjust expenses using the CPI on the grounds that the adjustments would be made based upon economic forecasts which are not known and measurable.

(3) Decision of the Commission: Upon consideration of this expense item, the Commission adopts the agreement of the Company and ORS that this adjustment should not be made.

(C) Transportation Expenses

(1) Position of CWS: The Company initially proposed to increase this expense by \$16,434 to reflect seven new vehicles (for the seven new employees described in the Salary and Wage adjustment discussion above), the purchase of which was documented. At hearing, CWS agreed with the position of ORS to disallow three of the seven new vehicles proposed for inclusion under this adjustment leaving a total adjustment of \$14,208.

(2) Position of ORS: ORS proposed that this adjustment be allowed only to the extent that the employees who would utilize the vehicles had been hired. This results in a lower adjustment of \$14,208.

(3) Decision of the Commission: Upon consideration of this expense item, the Commission adopts the adjustment agreed to by the Company and ORS.

(D) Deferred Expenses:

(1) Position of CWS: CWS did not propose an adjustment to this item but agreed with the ORS proposal at hearing.

(2) Position of ORS: ORS proposed an adjustment of \$4,960 for Deferred Charges. ORS proposed to remove from Deferred Expenses a recurring, anticipated expense for tank maintenance for water operations of (\$13,057), but to include current expenses in the test year for tank maintenance of \$29,902. ORS also proposed to defer and amortize over three years hurricane and storm expenses of \$17,828, resulting in a net deferral for this expense category of (\$11,885). The ORS proposed a total adjustment to Deferred Expenses of \$4,960 which consisted of (\$13,057) plus \$29,902 plus (\$11,885). According to ORS, this adjustment is consistent with treatment of deferred expenses in the Company's last rate case.

(3) Decision of the Commission: Upon consideration of this expense item, the Commission adopts the adjustment agreed to by the Company and ORS. In *Porter v. South Carolina Public Service Commission*, 328 S.C. 222, 493 S.E.2d 92 (1997), the Supreme Court of South Carolina reviewed our decision in a previous rate case filed by the Company and held that a deferred expense is extraordinary in nature, i.e., one which is neither recurring nor anticipated. Accordingly, routine expenses required at regular intervals do not qualify as extraordinary. The Commission adopts the adjustment proposed by ORS as it is based upon *Porter v. South Carolina Public Service Commission, supra*.

(E) Office Salaries:

(1) Position of CWS: The Company proposed an adjustment of \$35,479 to General & Administrative Expenses to annualize office salaries. At hearing, however, the Company agreed with the proposal of ORS for a smaller adjustment.

(2) Position of ORS: ORS also proposed to annualize Office Salaries. ORS annualized the year-end payroll totaling \$304,053. From this amount, ORS subtracted the per book amount of \$290,536 for a net adjustment of \$13,517.

(3) Decision of the Commission: Upon consideration of this expense item, the Commission adopts the adjustment agreed to by the Company and ORS.

(F) Rate Case Expenses:

(1) Position of CWS: CWS proposed an adjustment for estimated rate case expenses of \$123,432, amortized over three years, less per book fully amortized rate case expense for an adjustment of (\$60,482). CWS updated its rate case expenses prior to hearing through documentation supplied to ORS and seeks recovery of rate case expenses of \$171,902. These included legal and consulting fees, direct time spent by corporate office staff, travel and associated expenses. CWS proposed to amortize rate case expenses over a three year period. At hearing, CWS agreed with the ORS position on rate case expenses.

(2) Position of ORS: ORS accepts the Company's updated rate case expenses totaling \$171,902 and the proposed amortization period of three years, which results in an adjustment of \$57,301. ORS subtracted the per book fully amortized adjustment of \$101,626, resulting in an adjustment of (\$44,325). ORS also included an additional \$9,000 related to expenses to update the Company's performance bond, consistent with the testimony of ORS witness Hipp and Company witness Lubertozzi, yielding a total adjustment of (\$35,325).

(3) Decision of the Commission: Upon consideration of this expense item, the Commission adopts the adjustment agreed to by the Company and ORS.

(G) Pension and Other Benefits:

(1) Position of CWS: CWS proposed to annualize pension and other benefits associated with the wage adjustment for operators and office employees and proposed an adjustment of \$68,859. At hearing, CWS agreed with the ORS position on this adjustment.

(2) Position of ORS: ORS agreed that an adjustment was appropriate in this regard, but did not include part-time employee wages in its computation since they do not receive benefits. The ORS adjustment was \$45,435, which yields a test year pension and other benefits total, as adjusted, of \$251,971.

(3) Decision of the Commission: Upon consideration of this expense item, the Commission adopts the adjustment agreed to by the Company and ORS.

(H) Employee Bonuses:

(1) Position of CWS: CWS did not propose an adjustment to this item, but included in salaries and wages office employee bonuses of \$8,225 and corporate employee bonuses of \$14,462. At hearing, CWS agreed with the ORS adjustment to this expense item.

(2) Position of ORS: ORS proposed to remove bonuses for employees from operating expenses as it considers bonuses to be the responsibility of the stockholders, not the ratepayers. The total of the ORS adjustment is (\$22,687).

(3) Decision of the Commission: Upon consideration of this expense item, the Commission adopts the adjustment agreed to by the Company and ORS.

(I) Out of Period Expenses

(1) Position of CWS: CWS did not propose an adjustment for out of period expenses, but agreed at hearing with the ORS proposal for such an adjustment.

(2) Position of ORS: ORS proposed that test year expenses be adjusted to remove out of period expenses for property insurance (\$31,649), sewer rodding and maintenance and repairs (\$14,415) and non-allowable DHEC fines and entertainment expenses (\$22,850) for a total adjustment of (\$68,914).

(3) Decision of the Commission: Upon consideration of these expense items, the Commission adopts the adjustment agreed to by the Company and ORS.

(J) Depreciation Expense Adjustment:

(1) Position of CWS: CWS proposed an adjustment of \$79,436 to annualize Depreciation Expense. At hearing, CWS agreed with the position of ORS on depreciation expense adjustment.

(2) Position of ORS: ORS proposed to annualize Depreciation Expense with an adjustment of \$26,705. ORS' proposed adjustment included gross plant of \$37,107,047 plus verified plant to date of \$696,396 less Organization Expense, Land, Vehicles, Plant Acquisition Adjustment, and Advances in Aid for a net depreciable plant of \$36,588,217. ORS included depreciation expense associated with the Water Service Corporation rate base and for the amortization of excess book value. ORS made separate adjustments for the depreciation expense associated with the removal of wells. ORS used

a depreciation rate of 1.50% for plant other than vehicles and a 25.00% depreciation rate for vehicles per the recommendation of the ORS Water/Wastewater Department. ORS' total computed Depreciation amounted to \$616,647, less the per book amount of \$589,942, resulting in a net adjustment of \$26,705.

(3) Decision of the Commission: Upon consideration of these expense items, the Commission adopts the adjustment agreed to by the Company and ORS.

(K) Amortization of Contributions in Aid of Construction (CIAC):

(1) Position of CWS: CWS proposed to adjust the amortization for CIAC using a 1.50% depreciation rate. The total of CWS's proposed adjustment in this regard was \$15,286. At hearing, CWS agreed with the ORS position on this adjustment.

(2) Position of ORS: The ORS proposes to utilize the same depreciation rate as CWS, but submits an alternative calculation for this adjustment. Utilizing a gross per books CIAC amount of \$17,122,470, ORS calculates an amortization amount of (\$256,837). Subtracting the per book amount of (\$252,590) yields a total adjustment of (\$4,247).

(3) Decision of the Commission: Upon consideration of this expense item, the Commission adopts the adjustment agreed to by the Company and ORS.

(L) Retired Wells River Hills, I-20, Watergate and Westside Terrace:

(1) Position of CWS: CWS removed depreciation expense associated with wells which are no longer used and useful in its depreciation adjustment. At hearing, CWS agreed with the position of ORS on this matter.

(2) Position of ORS: ORS proposed an adjustment of (\$7,568) to remove depreciation expense for wells for the River Hills, I-20, Watergate and Westside Terrace water systems per the terms of the Commission's order in the last rate case.

(3) Decision of the Commission: Upon consideration of this expense item, the Commission adopts the adjustment agreed to by the Company and ORS.

(M) Extraordinary Retirement of Wells

(1) Position of CWS: CWS proposed to include \$29,924 in expenses as approved in the Company's last rate case.

(2) Position of ORS: ORS agreed with the Company's proposed adjustment.

(3) Decision of the Commission: Upon consideration of this expense item, the Commission adopts the adjustment agreed to by the Company and ORS as being consistent with our last rate case order for CWS.

(N) Property Taxes

(1) Position of CWS: CWS included \$8,559 in property taxes for the retired wells in River Hills, I-20, Watergate and Westside Terrace and improperly recorded \$264,492 in property taxes actually paid in the test year. At hearing, CWS agreed with ORS' proposed adjustment to correct these expense items.

(2) Position of ORS: ORS proposed an adjustment of (\$8,559) to delete taxes on the retired wells and \$264,492 to include test year property taxes that were not properly recorded.

(3) Decision of the Commission: Upon consideration of this expense item, the Commission adopts the adjustments agreed to by the Company and ORS.

(O) Other Taxes:

(1) Position of CWS: CWS did not propose an adjustment for Utility/Commission taxes and Gross Receipts taxes associated with as adjusted revenues. The Company agreed at hearing to ORS' proposed adjustment in this regard.

(2) Position of ORS: ORS proposed to adjust Utility/Commission taxes and Gross Receipts taxes by a factor of .010733226 to account for increases in Commission and ORS administration costs and a revenue tax from the Department of Revenue resulting from upward adjustments in revenue. This resulted in an adjustment to this expense item of \$2,656.

(3) Decision of the Commission: Upon consideration of this item, the Commission adopts the adjustment agreed to by the Company and ORS.

(P) Income Taxes:

(1) Position of CWS: CWS proposed to adjust taxes for accounting and pro forma adjustments. CWS used a 5% rate for state taxes and a 34% rate for federal taxes.

(2) Position of ORS: ORS also proposed to adjust for the effect of income taxes after accounting and pro forma adjustments. Like CWS, ORS used a 5% rate for state taxes and a 34% rate for federal taxes.

(3) Decision of the Commission: The Commission adopts the method proposed by the Company and ORS to adjust taxes for accounting and pro forma adjustments. The Commission finds that a 5% rate for state taxes and a 34% rate for federal taxes is appropriate as those are the actual tax rates that apply to CWS. Based on

the adjustments adopted herein, the Commission approves an adjustment to Income Taxes of \$117,583 to eliminate negative per book Income Taxes.

(Q) Interest on Customer Deposits:

(1) Position of CWS: The Company did not propose an adjustment for this item, but agreed at hearing with the adjustment proposed by ORS in this regard.

(2) Position of ORS: ORS proposed an adjustment to annualize Interest on Customer Deposits by using the ORS verified amount as of June 30, 2004, of \$183,354 and by applying the Commission approved interest rate of 3.5%. ORS computed annualized Interest on Customer Deposits of \$6,417 less the per book amount of \$9,728 for an adjustment of (\$3,311).

(3) Decision of the Commission: The Commission adopts the adjustment agreed to by the Company and ORS. This adjustment annualizes the Interest on Customer Deposits at the end of the test year at the interest rate of 3.5%, which is the Commission approved rate for interest on customer deposits.

(R) Allowance for Funds Used During Construction (AFUDC)

(1) Position of CWS: CWS proposed an adjustment of (\$17,756) to remove the Allowance for Funds Used During Construction ("AFUDC") from net income since it did not include Construction Work in Progress (CWIP) in rate base.

(2) Position of ORS: ORS agreed with the Company's proposed adjustment

(3) Decision of the Commission: The Commission adopts the adjustment on this item agreed to by the Company and ORS.

(S) Customer Growth

(1) Position of CWS: CWS did not propose a separate calculation for Customer Growth as a component of Income for Return. However, CWS did include a Customer Growth component in its calculation of water revenue to be produced under proposed rates. CWS included a growth factor of 6.34% which was applied to billing units and usage (gallons) in calculating water revenue to be produced under proposed rates. [Application, Revised Schedule D, p. 1 of 2 and Revised Schedule E, p.1 of 2.]

CWS also included a growth factor of 2.49% which was applied to billing units in calculating sewer revenue to be produced under proposed rates. [Application, Revised Schedule D, p. 2 of 2 and Revised Schedule E, p. 2 of 2.] At the hearing, CWS agreed to the ORS report which included growth in revenue and also included a growth calculation using net operating income.

(2) Position of ORS: ORS adopted the proposed increase of \$1,815,528 (\$180,854 for water and \$1,634,674 for sewer) as included in the Company's Application which, as discussed above, included Customer Growth. [ORS Revised Audit Exhibit SGS-1, Hearing Exhibit 19 and Application, Schedule B, p. 1 of 4.] ORS also included a separate calculation for Customer Growth of \$23,825 after the requested increase based on the Commission's established formula method. [ORS Revised Audit Exhibit SGS-1 and Revised Audit Exhibit SGS-7, Hearing Exhibit 19.]

(3) Decision of Commission: Based on our revenue findings included herein, the Commission finds that a separate calculation for Customer Growth is unnecessary for this proceeding and would, in fact, include Customer Growth twice if included. The

Commission, therefore, eliminates the Customer Growth of \$23,825, as discussed above, after the proposed increase.

(T) Taxes Other Than Income– Proposed Increase

(1) Position of CWS: The Company proposed to increase Taxes Other Than Income by \$32,680 to reflect the effect of the proposed increase. At hearing, CWS agreed to the ORS position on this item.

(2) Position of ORS: ORS proposed that Taxes Other Than Income be adjusted to reflect the effect of the proposed increase, but used a factor of 0.010733226 (0.007733226 for the Commission and ORS and 0.003 for the Department of Revenue) to arrive at an adjustment of \$19,486.

(3) Decision of the Commission: Upon consideration of this item, the Commission finds, based upon our revenue findings included herein, that Taxes Other Than Income should be increased by \$12,300 (\$1,146,000 times .010733226).

(U) Income Taxes – Proposed Increase

(1) Position of CWS: The Company proposed that Income Taxes be established using current tax rates on calculated taxable income, which yields \$659,765 in allowable income tax. At hearing, CWS agreed with the ORS position on this item.

(2) Position of ORS: ORS proposed that Income Taxes be established after taking into account the proposed increase, which yields \$569,502 in allowable income tax.

(3) Decision of the Commission: Based upon our revenue and expense findings included herein, the Commission finds that Income Taxes should be adjusted by \$324,380 based on taxable income after the increase as approved herein.

Summary of Adopted Adjustments to Expenses:

The total effect of the adjustments to test year expenses adopted herein increase Operating and Maintenance Expenses by \$160,533, decrease General and Administrative Expenses by (\$67,974), increase Depreciation and Amortization Expenses by \$14,890, increase Taxes Other Than Income by \$271,224, increase Income Taxes by \$117,583, reduce Interest on Customer Deposits by (\$3,311), increase extraordinary retirement expense by \$29,924 and reduce AFUDC by (\$17,756). The net effect of the adjustments adopted herein on Total Operating Expenses is to increase Total Operating Expenses by \$522,869. Thus, operating expenses for the test year under present rates and after accounting and pro forma adjustments and adjustments for known and measurable out-of-test year occurrences are \$5,276,647.

The following table indicates the Company's gross revenues for the test year after adjustments approved herein, under the presently approved rate schedules; the Company's operating expenses for the test year after accounting and pro forma adjustments and adjustments for known and measurable out-of-test year occurrences approved herein; and the rate of return on rate base under the presently approved schedules for the test year:

TABLE B

	<u>Before Increase</u>
Operating Revenues	\$5,674,555
Operating Expenses	<u>5,276,647</u>
Net Operating Income	\$ 397,908
ADD: Allowance for Funds Used During Construction	0
Customer Growth	<u>0</u>
TOTAL INCOME FOR RETURN	<u>\$ 397,908</u>
 Return on Rate Base	 <u>2.66%</u>

11. The appropriate rate base for CWS for the test year after accounting and pro forma adjustments and adjustments for known and measurable occurrences outside the test year is \$14,940,867.

The evidence supporting this finding is contained in the Company's application and in the testimonies of Company witness Lubertozzi and ORS witness Scott. ORS offered certain adjustments to the Company's proposed rate base which the Company accepted. [Scott Pre-filed Revised Direct testimony, Tr. p. 443, l. 16 - p. 446, l. 21; Lubertozzi Rebuttal Pre-filed testimony, Tr. p. 490, ll. 19-22, Tr. p. 491, ll. 10-14.] No other party of record offered testimony pertaining to the Company's rate base or proposed adjustments thereto. The adjustments to rate base agreed to by the Company and ORS, and the Commission's determination as to each, are as follows:

(A) Removal of Wells

(1) Position of CWS: CWS proposed to remove from gross plant in service wells no longer used and useful in accordance with our last rate case order for the Company. See Item L, above. The CWS proposal of (\$277,315) included accumulated depreciation and did not take into account the plant costs for Westside Terrace. At hearing, CWS agreed with ORS' proposed adjustment.

(2) Position of ORS: ORS proposed to exclude \$10,804 of accumulated depreciation since the wells are no longer in service and to include plant costs of \$11,118 for Westside Terrace for a total adjustment to gross plant in service of (\$299,237).

(3) Decision of the Commission: Upon consideration of this item, the Commission adopts the adjustment agreed to by the Company and ORS.

(B) Excess Book Value

(1) Position of CWS: CWS proposed to remove Excess Book Value carried forward from the Company's last rate case. CWS calculated the amount of this adjustment to be (\$941,517) based upon a carry forward balance of \$978,199 amortized at 1.50%. At hearing, CWS agreed to the calculation for this item proposed by ORS.

(2) Position of ORS: ORS agreed that Excess Book Value should be removed using a 1.50% amortization rate, but calculated the carry forward balance to be \$1,026,646, which results in an adjustment of (\$924,905).

(3) Decision of the Commission: Upon consideration of this item, the Commission adopts the adjustment agreed to by the Company and ORS.

(C) Plant Sample Items

(1) Position of CWS: Per the order in the Company's last rate case, CWS proposed to remove plant sample items from rate base since the adjustment was not made per books in the amount of (\$9,108). At hearing, CWS agreed with the ORS calculation of this adjustment.

(2) Position of ORS: ORS also proposed an adjustment to rate base to remove plant sample items, but calculated the adjustment amount to be (\$8,597) to correct a mathematical error.

(3) Decision of the Commission: Upon consideration of this item, the Commission adopts the adjustment agreed to by the Company and ORS.

(D) Plant Additions

(1) Position of CWS: CWS proposed to adjust for plant additions.

(2) Position of ORS: ORS agreed that known and measurable plant additions providing service to present customers should be included and verified this amount to be \$696,396.

(3) Decision of the Commission: Upon consideration of this item, the Commission adopts the adjustment as calculated by ORS.

(E) Vehicles for New Employees

(1) Position of CWS: CWS proposed an adjustment of \$138,000 to include seven (7) new vehicles for new employees. See Items A and C, above under Finding of Fact No. 10. At hearing, CWS agreed with the adjustment proposed by ORS in this regard.

(2) Position of ORS: ORS proposed that an adjustment of \$82,829 be allowed for four (4) of the documented new vehicles to be utilized by the four (4) new employees which had been hired by the time of hearing.

(3) Decision of the Commission: Upon consideration of this item, the Commission adopts the adjustment agreed to by the Company and ORS.

(F) Pro Forma Plant

(1) Position of CWS: CWS proposed an adjustment for other pro forma plant of \$1,918,185.

At hearing, CWS agreed with the ORS position on this adjustment.

(2) Position of ORS: ORS proposed that no adjustment be allowed since the pro forma plant had not been placed into service as of December 31, 2004 and no known and measurable data supported making the adjustment.

(3) Decision of the Commission: Upon consideration of this item, the Commission adopts the ORS position on this adjustment which was agreed to by the Company.

(G) Capitalized Wages

(1) Position of CWS: CWS did not propose an adjustment for this item, but agreed at hearing to ORS' proposed adjustment.

(2) Position of ORS: ORS proposed an adjustment of \$50,685 to book to plant the portion of operators' wages, taxes and benefits associated with capital projects.

(3) Decision of the Commission: Upon consideration of this item, the Commission adopts the ORS position on this adjustment which was agreed to by the Company.

(H) Accumulated Depreciation

(1) Position of CWS: The Company proposed an accumulated depreciation adjustment of \$35,529 for removal of the wells, excess book value and post June 30, 2004 plant additions. At hearing, CWS agreed to the ORS position on this adjustment.

(2) Position of ORS: ORS proposed to adjust accumulated depreciation by (\$26,705) consistent with its annualized depreciation expense calculation. ORS further proposed that accumulated depreciation for wells and plant sample items from the last rate case totaling \$26,939 be removed resulting in a net adjustment of \$234.

(3) Decision of the Commission: Upon consideration of this item, the Commission adopts the ORS position on this adjustment which was agreed to by the Company.

(I) Cash Working Capital

(1) Position of CWS: CWS proposed to adjust cash working capital based on pro forma expense by \$50,343. At hearing, CWS agreed to the position of ORS on this adjustment.

(2) Position of ORS: ORS proposed an adjustment to cash working capital based on pro forma expenses excluding Taxes Other Than Income as a working capital item since that is ordinarily an accrual that does not require a cash outlay and CWS

would have collected it from customers in advance of paying certain taxes. The resultant adjustment is (\$46,496).

(3) Decision of the Commission: Upon consideration of this item, the Commission adopts the ORS position on this adjustment which was agreed to by the Company.

(J) Water Service Corporation (WSC) - Rate Base

(1) Position of CWS: CWS proposed an (\$8,457) adjustment to the WSC rate base which includes deferred expenses from the last rate case. At hearing, CWS agreed to the ORS position on this item.

(2) Position of ORS: ORS agreed that the WSC rate base should be adjusted, but proposed that the deferred expenses allocated to the Company be removed from the WSC rate base verified by ORS. The ORS asserts that certain deferred charges that are allowed in expenses should not be permitted in rate base which results in a sharing of expenses between customer and stockholder. The resultant adjustment is (\$2,609).

(3) Decision of the Commission: Upon consideration of this item, the Commission adopts the ORS position on this adjustment which was agreed to by the Company.

(K) Advances in Aid of Construction

(1) Position of CWS: The Company did not propose an adjustment to this item, but agreed at hearing to the ORS position in this regard.

(2) Position of ORS: ORS proposed to remove Advances in Aid of Construction of \$1,600 from Rate Base, which are owed to the customer, on the grounds that CWS should not be permitted to earn a return on customer supplied funds.

(3) Decision of the Commission: Upon consideration of this item, the Commission adopts the ORS position on this adjustment which was agreed to by the Company.

(L) Customer Deposits

(1) Position of CWS: CWS did not include \$245,763 as a reduction in rate base that consisted of accrued interest owed to customers on deposits. At hearing, CWS agreed to the ORS position on this item.

(2) Position of ORS: ORS proposed to exclude from rate base interest accrued and due customers on deposits on the grounds that a return should not be permitted on customer supplied funds. The resultant adjustment would be (\$245,763).

(3) Decision of the Commission: Upon consideration of this item, the Commission adopts the ORS position on this adjustment which was agreed to by the Company.

Summary of Adopted Adjustments to Rate Base:

The total effect of the adjustments to rate base adopted herein reduce Gross Plant in Service by (\$402,829), decrease Accumulated Depreciation by \$234 [thereby resulting in a reduction to Net Plant in Service of (\$402,595)], reduce Cash Working Capital by (\$46,496), reduce WSC rate base by (\$2,609), include Advances in Aid of Construction of (\$1,600) and include accrued interest on Customer Deposits of (\$245,763). The total

of the adjustments adopted herein reduce total rate base by (\$699,063). Thus, after the adjustments adopted herein, as adjusted rate base is \$14,940,867. The following table indicates the Company's rate base for its jurisdictional operations in South Carolina after accounting and pro forma adjustments approved herein:

TABLE C

Gross Plant in Service	\$36,704,218
LESS: Accumulated Depreciation	<u>(4,781,663)</u>
Net Plant in Service	\$31,922,555
ADD:	
Cash Working Capital	521,361
Water Service Corp. – Rate Base	127,824
DEDUCT:	
Advances in Aid of Construction	(1,600)
Contributions in Aid of Construction	(15,195,347)
Plant Acquisition Adjustment	(482,719)
Accumulated Deferred Income Taxes	(1,522,090)
Customer Deposits	<u>(429,117)</u>
TOTAL YEAR END RATE BASE	<u>\$ 14,940,867</u>

12. The income requirement for CWS, using the return on rate base of 8.02% found appropriate in this Order and the adjusted rate base of \$14,940,867, is \$1,198,366.

Under rate of return on rate base regulation, the Commission must approve an income requirement that will permit the Company to cover operating costs and provide an opportunity to earn the approved rate of return on rate base. The determination of the income requirement requires a calculation using approved Operating Revenues and approved Operating Expenses to determine Net Operating Income for Return. Net Operating Income for Return is then increased for approved AFUDC and approved

Customer Growth resulting in Total Income for Return. The following table illustrates the calculations of CWS's Total Income for Return:

TABLE D

	<u>After Increase</u>
Operating Revenues	\$6,811,693
Operating Expenses	<u>5,613,327</u>
Net Operating Income For Return	\$1,198,366
ADD: Allowance for Funds Used During Construction	0
Customer Growth	<u>0</u>
TOTAL INCOME FOR RETURN	<u>\$1,198,366</u>
 Return on Rate Base	 <u>8.02%</u>

As demonstrated on Table D, Total Income for Return after the increase approved herein is \$1,198,366.

13. In order for CWS to have the opportunity to earn its income requirement of \$1,198,366, CWS must be allowed additional revenues totaling \$1,146,000 or \$1,137,138 after uncollectibles.

In order for the Company to have the opportunity to earn the 8.02% rate of return on rate base approved herein, the Commission must increase revenues sufficient to achieve a Total Income for Return of \$1,198,366, as calculated in Finding of fact No. 12. The additional revenue calculated for the Company to have the opportunity to earn its approved rate of return of 8.02% requires an increase of \$1,146,000.

14. In designing rates for CWS, a uniform rate schedule for customers is appropriate. Accordingly, the sewer rates for customers in Lincolnshire service area, I-20 service area, Lexington service area, Kings Grant service area, and Teal on the Ashley service area will be increased to a level commensurate with those to be charged to other customers.

Upon determination of the revenue requirements for a utility in a ratemaking proceeding, the next step is the determination of the specific rates or rate structure that will yield the required revenues. A generally accepted principle is that proper utility regulation requires the exercise of control over a utility's rate structure. *The Regulation of Public Utilities, supra*.

In designing rates for the Company, the Commission strives to set rates that are "just and reasonable" and without undue discrimination. In the case before the Commission, CWS has requested uniform rates. The Commission finds that such a uniform rate schedule is fair and reasonable and is in the best interests of the customers and CWS. In the Company's last rate case, it did not seek increases for those customers in the Lincolnshire service area, the I-20 service area, and the Lexington service area. Order No. 2001-887 at 68. The reasoning for this divergence in rates as expressed by CWS's witness in that proceeding was that the status of the Company's operation and even its ownership of the systems serving those areas was in a state of flux. *Id.* Those systems were operating under expired NPDES or ND permits and were the subject of either current or potential litigation. *Id.* The uncertainty of the outcome of the issues involving those service areas led CWS not to seek rate relief for sewer treatment in those

service areas. *Id.* Because the Commission felt that similar circumstances appertained with respect to the Company's Kings Grant and the Teal on the Ashley service areas, we found it appropriate to exclude the customers in those service areas from the sewer rate increase as well as those excluded by CWS's application. In short, our departure from a uniform rate structure in the Company's last rate case was warranted by special facts and circumstances. *See August Kohn & Co. Inc. v. Public Service Comm'n*, 290 S.C. 409, 313 S.E.2d 630 (1984). However, the Commission concludes that these special facts and circumstances no longer exist.

At hearing in the instant proceeding, Company witness Lubertoizzi observed that even though some of the circumstances regarding the excluded sewer service areas had not changed since the last rate case, continued exclusion of these areas was no longer warranted. [Lubertoizzi Pre-filed Direct testimony, Tr. p. 291, ll. 5 - 26.] Mr. Lubertoizzi stated that the Company's position in this regard in the last rate case was predicated upon its belief that uncertainties regarding the ultimate disposition of these sewer systems would have been resolved prior to the instant filing. [*Id.*, Tr. p. 291, l. 28 - p. 292, l. 5.] That belief has now been disproven and no other party of record produced evidence to demonstrate that these uncertainties would be resolved at any near date. Thus, rather than being a "special" circumstance as contemplated in *August Kohn, supra*, the evidence of record demonstrates that, in any given rate case, the Company may be expected to have unresolved issues regarding future ownership and/or interconnection of its treatment facilities. Moreover, the application reveals that the Company currently holds valid

permits from DHEC for the operation of all five of these sewer facilities. [See Application Exhibit “C.”]

We conclude that the further exclusion of these five sewer service areas from rate adjustments is not warranted. We are mindful that the impact of the increase in sewer rates approved by this order on customers in these areas will be greater than that felt by other customers. However, countervailing that is the fact that the customers in these five areas will have enjoyed lower sewer rates than the Company’s other sewer customers for nearly four (4) years by the time the rates approved herein will become effective. Moreover, to continue excluding customers in these areas from rate adjustments would foster undue discrimination against other customers. *Cf., The Regulation of Public Utilities, supra*, at 171. It is incumbent upon us to approve rates which **fairly** distribute the Company’s revenue requirement. *Seabrook Island POA v. S.C. Public Service Comm’n*, 303 S.C. 493, 401 S.E.2d 672 (1991). In light of the foregoing, a fair distribution of the Company’s revenue requirement cannot exist if large numbers of sewer customers continue to be excepted from rate adjustments and we decline to do so.

15. The resultant operating margin for CWS, based upon the adjustments and rates approved herein, is 8.13%. S.C. Code Ann. Section 58-5-240(H) (Supp.2004) provides, in part, that “[t]he [C]ommission shall specify an allowable operating margin in all water and wastewater orders.” Based upon the rate of return on rate base approved herein and the revenues and expenses also approved herein, the corresponding operating margin is calculated to be 8.13%. The following Table reflects an operating margin of 8.13%:

TABLE E

Operating Revenues	\$6,811,693
Operating Expenses	<u>5,613,327</u>
Net Operating Income	\$1,198,366
ADD: Allowance for Funds Used During Construction	0
Customer Growth	<u>0</u>
Total Income for Return	<u>\$1,198,366</u>
Operating Margin (After Interest Expense of \$644,242) ⁷	<u>8.13%</u>

16. The Company's requested modifications to its water and sewer rate schedule provisions pertaining to billing tenants for the convenience of a landlord and the addition of a provision to its water rate schedule for implementing a cross-connection control program are appropriate as being in the public interest and are hereby approved.

The evidence supporting this finding of fact is contained in the Company's application, the testimony of its witness Haas [Haas Pre-filed Direct Testimony, Tr. p. 325, l.25 - p. 327, l. 2], and the testimony of ORS witness Hipp [Hipp Pre-filed Direct Testimony, Tr. p. 420, ll. 1-14.] As noted by both witnesses, an amendment to S.C. Code Ann. § 27-33-50 (Supp. 2004) requires a revision to the tenant billing provisions of the Company's rate schedule. We further agree with these witnesses that DHEC regulation 24A S.C. Code Ann. R. 61-58.7.F.8 prohibits maintenance of a cross-connection to a

⁷ CWS proposed to include interest expense of \$735,823 based upon the Company's as adjusted rate base, 59.23%/40.77% debt/equity ratio and a cost of debt of 7.28%. ORS proposed to include interest expense of \$644,242, which results in an adjustment to the Company proposal of (\$91,581), to reflect usage of the adjusted rate base and not the Company's pro forma rate base. At hearing, CWS agreed to the ORS position on this item. The Commission adopts the ORS position on this adjustment which was agreed to by the Company.

public water system unless a cross-connection inspection is performed annually on required backflow prevention devices. Because it is the decision of a customer to install a cross-connection, the burden of compliance with the DHEC regulations in this regard should be borne by the customer. Given that ORS supports these modifications, and no other party opposed them, we find the Company's requested rate schedule modifications to be in the public interest and approve same.

17. The night hearings conducted by the Commission in this Docket raised quality of service issues, specifically related to customer service, water quality, and compliance with the regulations of the South Carolina Department of Health and Environmental Control (DHEC).

(A) Customer Service

This Commission heard a great deal of testimony from CWS customers in our night hearings regarding the quality of service which those customers had received. Almost without exception, the testimony painted an unflattering picture of the Company. The testimony presented instances of sewer backups, difficulty establishing service connections, termination of service incidents, and rude treatment from CWS personnel. On the other hand, we note that ORS witness Hipp testified that CWS' customer complaint procedures are in compliance with PSC regulations, and that she "was pleased with their complaint, their ability to handle and log and track complaints, with their ability versus some other companies". [Tr. p. 429.] We are also mindful of the Company's rebuttal testimony in this regard [e.g. Tr., Haas at 464] The public hearing

testimony is anecdotal in nature, but it is nevertheless a cause for concern. At a minimum, there is no question that Carolina Water Service has a serious customer relations problem.

Also, although it is clear that CWS maintains records of customer complaints by entering the details of each telephone call or written complaint into a computerized database⁸, it is apparent that CWS did not have a systematic approach to reviewing these complaints and their outcomes. Complaints were entered into a database, and customer complaints were anecdotally reviewed in monthly Staff meetings. However, Company witness Haas testified that no periodic reports of customer complaints were generated by the Company, which would allow the company to be aware of the volume of its customer complaints. [Tr., pp. 367-369.] This Commission has always considered customer service and quality of service to be components of rate cases. *Seabrook Island Property Owners Ass'n. v. South Carolina Public Service Commission*, 303 S.C. 493, 498, 401 S.E.2d 672, 674 (1991). It is also important that CWS's customers have some way to determine whether the company is addressing their concerns. Accordingly, we hold that the following measures shall be instituted to deal with this issue:

1. Beginning December 31, 2005, Carolina Water Service shall generate semesterly reports of its customer complaints, and provide them to the Office of Regulatory Staff for review and such further action as that agency shall deem appropriate. The reports should include, at a minimum, all information required by 26 S.C. Code Ann. Regs. 103-516 and 103-716 (Supp. 2004), including the

⁸ Prefiled testimony of Hipp, p. 4.

name and address of each complainant, the date and character of the complaint, and the adjustment or disposal made thereof;

2. Carolina Water Service shall notify each customer, through its monthly bills, of its complaint procedures, and provide its customers with the toll-free telephone number for the Office of Regulatory Staff;

3. Carolina Water Service shall notify any customer making a complaint that remains unresolved after seven days, that the utility is under the jurisdiction of this Commission and that the customer may contact ORS directly regarding their complaint, and that in providing such notice, that Carolina Water Service furnish the complaining customer with ORS' toll-free telephone number and mailing address.

We would note that if the Company's customer complaint records reveal a problem, there are several remedies available to ORS and the public, including, but not limited to petitions for sanctions and penalties, or even a request for a review and reduction of the Company's rates. See, e.g., S.C. Code Ann. Section 58-5-290 (1976).

(B) Water Quality

A number of Carolina Water Service's customers complained of poor water quality. However, there is no testing data in the record which would allow this Commission to make findings regarding the odor, taste, or turbidity of the Company's water in connection with this rate hearing. These complaints are a cause of concern to this Commission, since the Company's customers are entitled to get what they pay for. Accordingly, we hold as follows:

1. ORS shall develop tests for compliance with 26 S.C. Code Ann. Regs. 103-770 and other applicable statutes and regulations which require water to be potable, and insofar as practicable, free from objectionable odor, taste, color and turbidity.

2. ORS shall conduct such tests on the water produced by the facilities connected with this case within twelve (12) months from the date of this Order, in such frequency as it deems necessary to ascertain compliance, so that ORS and this Commission may take additional action, if any, that they deem necessary based on the results of these tests.

(C) DHEC Compliance

There is testimony in the record that Carolina Water Service has been fined by DHEC on several occasions, but there is no record before the Commission explaining the specific nature of these violations or the amount of the fines. [Tr. Lubertozzi, p. 511-512] We would note the language of 26 S.C. Code Ann. Regs. 103-713 (C), which states in part that "...Water Utilities under the jurisdiction of the Commission shall file with the Commission in writing a notice of any violation of PSC or DHEC rules which affect the service provided to its customers. This notice shall be filed within 24 hours of the time of the inception of the violation and shall detail the steps to be taken to correct the violation, if violation is not corrected at time of occurrence. The Company shall notify the Commission in writing within 14 days after the violation has been corrected." ORS witness Dawn Hipp testified that the Company had failed to file these notices. [Tr., p. 416.]

The Company has taken the position that it was not obligated to report these violations – the nature of which are still unknown – to the Commission or to ORS. This Commission is troubled by this lack of information and believes that it is important that the ORS be timely provided with such data.

Accordingly, we hold that DHEC violations, by their very nature, affect the service provided to Carolina Water Service's customers, and that the Company:

1. shall file with ORS, in writing, a notice of any violation of DHEC rules or regulations as determined by DHEC, within 24 hours of the time of a finding that the violation occurred, and
2. shall detail the steps to be taken to correct the violation if the violation is not corrected at the time of its occurrence, and to also notify ORS in writing within 14 days after the violation has been corrected; and
3. within 60 days of the date of this Commission's Order, to provide ORS with such data regarding any violations of DHEC rules and regulations which have occurred over the previous twelve months.

This reporting system will allow ORS to make an informed determination about the Company's compliance with DHEC rules and regulations, provide a database on this topic, and will also allow ORS to take action, if any, that it deems necessary in the future.

18. It is in the public interest to require a performance bond in the amount of \$700,000 for the Company.

The Commission's regulations state bond amounts must range from an amount not less than \$100,000 and not more than \$350,000. The bond amount is also set forth in

S.C. Code Ann. § 58-5-720 (Supp. 2004). ORS witness Dawn Hipp testified that the bond requirement for CWS should be increased to \$350,000 for water operations and \$350,000 for sewer operations based on expenses from the test year. [Tr., pp. 417-418.] Therefore, this Commission finds that in order to provide sufficient financial assurance to both the customer and the Commission in the event that the Company fails to provide safe and adequate service, a bond in the amount of \$700,000 is required.

IV. CONCLUSIONS OF LAW

Based upon the Findings of Fact as contained herein and the record of the instant proceeding, the Commission makes the following Conclusions of Law:⁹

1. Rate of return on rate base is the appropriate guide for the Commission to use in determining the lawfulness of the rates of CWS and in fixing of just and reasonable rates for CWS to charge its customers in South Carolina.
2. A fair rate of return on rate base for the operation of CWS in South Carolina is 8.02%. This rate of return is calculated using a capital structure of 59.23% debt and 40.77% equity, a cost of debt of 7.28%, and a return on equity of 9.10%. Based on the discussion and analysis of the Commission as detailed in this Order, these components of capital structure, cost of debt, and cost of equity and the resulting rate of return on rate base produce a fair and reasonable rate of return which the Company should have the opportunity to earn.

⁹ The Commission's analyses which give rise to the Conclusions of Law are contained in the discussions of Section III of this Order.

3. For the test year of June 30, 2004, the appropriate operating revenues, under present rates and as adjusted in this Order, are \$5,674,555, and the appropriate operating expenses, under present rates and as adjusted in this Order, are \$5,276,647.

4. Using the rate base as adjusted in this Order of \$14,940,867 and the return on rate base of 8.02% found to be fair and reasonable in this Order, the income requirement for CWS is \$1,198,366.

5. In order for CWS to have an opportunity to earn the return on rate base found reasonable and approved in this Order and to meet the income requirement, CWS must be allowed additional revenues of \$1,146,000.

6. The rates approved in this Order are designed to be just and reasonable without undue discrimination and are also designed to meet the revenue requirements of the Company.

7. Based on the adjustments approved herein and the increase in rates approved herein, the appropriate operating margin for CWS on its South Carolina operations is 8.13%.

8. The Company's requested modifications to certain terms and conditions of service in its rate schedule is in the public interest.

9. The Company shall institute the notification and reporting requirements with regard to customer service, water quality, and DHEC compliance as stated supra.

10. The appropriate bond requirement for the Company is \$700,000.

CONCLUSION

This Commission is aware that this Order will be a source of some public consternation. The law requires that CWS be allowed to earn a reasonable rate of return for its services, and in deciding on such a rate, the Commission is constrained by the evidence before it and the applicable law. No party to this case argued that CWS' application for a rate increase should be denied altogether, they only disagree as to the size of the recommended increase. The Commission considered the rate of return testimony provided by CWS' expert witness and the testimony of the expert called by the Office of Regulatory Staff and set a rate accordingly. We have considered the testimony of the many CWS customers who attended public hearings and expressed dissatisfaction with the service which they are receiving and the rates that they are paying. While these comments cannot be ignored, the testimony does not give the Commission a basis for declining CWS' Application. In *Heater Utilities, Inc. v. Public Service Commission of South Carolina*, Memorandum Op. No. 95-MO-365 (S.C. S.Ct. Dec. 8, 1995) the South Carolina Supreme Court reversed this Commission's decision to deny a rate increase because of "the absence of any scientific criteria" to support its decision. In other words, while the Commission finds that the testimony of the Company's customers is relevant to these proceedings, it cannot form the sole basis for denying a rate increase in the absence of other objective, quantifiable, evidence. This Commission was not presented with any quantifiable, objective data regarding water quality, sewerage odors, or customer service which could provide the basis for denying CWS's rate increase. Nevertheless, the Commission has herein adopted detailed measures designed to address such problems,

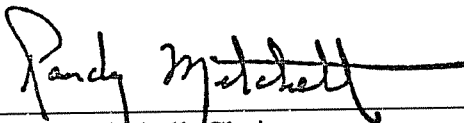
and to adequately document the company's future service. At the hearing, we were also informed by ORS that the agency will conduct a management audit of CWS. We welcome the initiative, which, at a minimum, will help reassure those customers who are concerned that increased rates will not be accompanied by quality service.

IT IS THEREFORE ORDERED THAT:

1. CWS is granted the opportunity to earn a rate of return on rate base for its water and sewer operations in South Carolina of 8.02%.
2. The schedule of rates and charges attached hereto as Appendix A, which include the Company's proposed modifications, are hereby approved for service rendered on or after the date of this Order. Further, the schedules are deemed to be filed with the Commission pursuant to S.C. Code Ann. Section 58-5-240 (Supp. 2004).
3. Should the schedules approved herein and attached hereto as Appendix A not be placed in effect until three (3) months from the effective date of this Order, the schedules shall not be charged without written permission from the Commission.
4. CWS shall maintain its books and records for water and sewer operations in accordance with the NARUC Uniform System of Accounts for Class A Water and Sewer Utilities, as adopted by this Commission.
5. The Company shall institute the notice and reporting requirements with regard to customer service, water quality, and DHEC compliance as stated supra.
6. CWS shall post with this Commission a bond with a face value of \$700,000 to satisfy the findings in this Order within ninety (90) days of receipt of this Order.

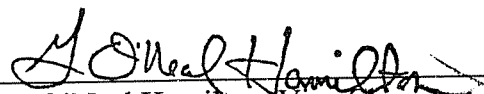
7. This Order shall remain in full force and effect until further Order of the Commission.

BY ORDER OF THE COMMISSION:



Randy Mitchell, Chairman

ATTEST:



G. O'Neal Hamilton, Vice Chairman

(SEAL)

APPENDIX A

CAROLINA WATER SERVICE, INC.

FILED PURSUANT TO DOCKET NO. 2004 -357-WS – ORDER NO. 2005-328
EFFECTIVE DATE: JUNE 22, 2005

SCHEDULE OF RATES AND CHARGES WATER

1. Monthly Charges

Residential

Base Facilities Charge per single family
house, condominium, mobile home
or apartment unit: \$10.25 per unit

Commodity Charge: \$3.32 per 1,000
gallons or 134 cft

Commercial

Base Facilities Charge
by meter size:

5/8" meter	\$10.25
1" °	\$25.62
1.5" °	\$51.25
2" °	\$82.00
3" °	\$164.00
4" °	\$256.25

Commodity Charge: \$3.32 per 1,000
gallons or 134 cft

Charges for Water Distribution Only

Where water is purchased from a government body or agency or other entity
for distribution and resale by the Company, the following rates apply:

Residential

Base Facilities Charge per single family
house, condominium, mobile home
or apartment unit: \$10.25 per unit

Commodity charge: \$1.90 per 1,000
gallons or 134 cft

CommercialBase Facilities Charge
by meter size:

5/8" meter		\$10.25
1" ◦		\$25.62
1.5" ◦		\$51.25
2" ◦		\$82.00
3" ◦		\$164.00
4" ◦		\$256.25

Commodity charge: \$1.90 per 1,000
gallons or 134 cft

The Utility will also charge for the cost of water purchased from the government body or agency, or other entity. The charges imposed or charged by the government body or agency, or other entity providing the water supply will be charged to the Utility's affected customers on a pro rata basis without markup. Where the Utility is required by regulatory authority with jurisdiction over the Utility to interconnect to the water supply system of a government body or agency or other entity and tap/connection/impact fees are imposed by that entity, such tap/connection/impact fees will also be charged to the Utility's affected customers on a pro rata basis, without markup.

Commercial customers are those not included in the residential category above and include, but are not limited to hotels, stores, restaurants, offices, industry, etc.

The Utility will, for the convenience of the owner, bill a tenant in a multi-unit building, consisting of four or more residential units (or in such other circumstances as the law may allow from time to time), which is served by a master water meter or a single water connection. However, in such cases all arrearages must be satisfied before service will be provided to a new tenant or before interrupted service will be restored. Failure of an owner to pay for services rendered to a tenant in these circumstances may result in service interruptions.

When, because of the method of water line installation utilized by the developer or owner, it is impractical to meter each unit separately, service will be provided through a single meter, and consumption of all units will be averaged; a bill will be calculated based on that average and the result multiplied by the number of units served by a single meter.

APPENDIX A

Docket No. 2004-357-W/S – Order No. 2005-328

June 22, 2005

Page 3

2. Nonrecurring Charges
 - A) Water Service Connection (New connections only) \$300 per SFE*
 - B) Plant Impact Fee (New connections only) \$400 per SFE*

3. Account Set-Up and Reconnection Charges
 - a. Customer Account Charge - for new customers only.
All Areas \$ 13.50

b. Reconnection Charges: In addition to any other charges that may be due, a reconnection fee of thirty five dollars (\$35.00) shall be due prior to the Utility reconnecting service which has been disconnected for any reason set forth in Commission Rule R.103-732.5. Customers who ask to be reconnected within nine months of disconnection will be charged the monthly base facility charge for the service period they were disconnected. The reconnection fee shall also be due prior to reconnection if water service has been disconnected at the request of the customer.

4. Billing Cycle

Recurring charges will be billed monthly in arrears. Nonrecurring charges will be billed and collected in advance of service being provided.

5. Extension of Utility Service Lines and Mains

The Utility shall have no obligation at its expense to extend its utility service lines or mains in order to permit any customer to connect to its water system. However, anyone or any entity which is willing to pay all costs associated with extending an appropriately sized and constructed main or utility service line from his/her/its premises to any appropriate connection point, to pay the appropriate fees and charges set forth in this rate schedule, and comply with the guidelines and standards hereof, shall not be denied service, unless water supply is unavailable or unless the South Carolina Department of Health and Environmental Control or other government entity has restricted the Utility from adding for any reason additional customers to the serving water system. In no event will the Utility be required to construct additional water supply capacity to serve any customer or entity without an agreement acceptable to the Utility first having been reached for the payment of all costs associated with adding water supply capacity to the affected water system.

6. Cross Connection Inspection Fee

Any customer installing, permitting to be installed, or maintaining any cross connection between the Utility's water system and any other non-public water system, sewer or a line from any container of liquids or other substances, must install an approved back-flow prevention device in accordance with 24A S.C. Code Ann. Regs. R.61-58.7.F.2 (Supp. 2003), as may be amended from time to time. Such a customer shall annually have such cross connection inspected by a licensed certified tester and provide to Utility a copy of a written inspection report and testing results submitted by the certified tester in accordance with

24A S.C. Code Ann. Regs. R.61—58.7.F.8.(Supp. 2003), as may be amended from time to time. Said report and results must be provided by the customer to the Utility no later than June 30th of each year. Should a customer subject to these requirements fail to timely provide such report and results, Utility may arrange for inspection and testing by a licensed certified tester and add the charges incurred by the Utility in that regard to the customer's next bill.

- * A Single Family Equivalent (SFE) shall be determined by using the South Carolina Department of Health and Environmental Control Guidelines for Unit Contributory Loadings for Domestic Wastewater Treatment Facilities -- 25 S.C. Code Ann. Regs. 61-67 Appendix A (Supp. 2003), as may be amended from time to time. Where applicable, such guidelines shall be used for determination of the appropriate monthly service and tap fee.

SCHEDULE OF RATES AND CHARGES

SEWER

1. Monthly Charges

Residential - charge per single-family house, condominium, villa, or apartment unit:	\$36.46 per unit
Mobile Homes:	\$26.20 per unit
Commercial:	\$36.46 per SFE*

Commercial customers are those not included in the residential category above and include, but are not limited to, hotels, stores, restaurants, offices, industry, etc.

Charge for Sewer Collection Only

When sewage is collected by the Utility and transferred to a government body or agency, or other entity, for treatment, the Utility's rates are as follows:

Residential - per single-family house, condominium, or apartment unit	\$23.47 per unit
Commercial - per single-family equivalent	\$23.47 per SFE*

The Utility will also charge for treatment services provided by the government body or agency, or other entity. The rates imposed or charged by the government body or agency, or other, entity providing treatment will be charged to the Utility's affected customers on a pro rata basis, without markup. Where the Utility is required under the terms of a 201/208 Plan, or by other regulatory authority with jurisdiction over the Utility, to interconnect to the sewage treatment system of a government body or agency or other entity and tap/connection/impact fees are imposed by that entity, such tap/connection/impact fees will be charged to the Utility's affected customers

on a pro rata basis, without markup.

The Utility will, for the convenience of the owner, bill a tenant in a multi-unit building, consisting of four or more residential units (or in such other circumstances as the law may allow from time to time), which is served by a master sewer meter or a single sewer connection. However, in such cases all arrearages must be satisfied before service will be provided to a new tenant or before interrupted service will be restored. Failure of an owner to pay for services rendered to a tenant in these circumstances may result in service interruptions.

Solids Interceptor Tanks

For all customers receiving sewage collection service through an approved solids interceptor tank, the following additional charges shall apply:

A. Pumping Charge

At such time as the Utility determines through its inspection that excessive solids have accumulated in the interceptor tank, the Utility will arrange for pumping the tank and will include \$150.00 as a separate item in the next regular billing to the customer.

B. Pump Repair or Replacement Charge

If a separate pump is required to transport the customer's sewage from solids interceptor tank to the Utility's sewage collection system, the Utility will arrange to have this pump repaired or replaced as required and will include the cost of such repair or replacement and may be paid for over a one year period.

C. Visual Inspection Port

In order for a customer who uses a solids interceptor tank to receive sewage service from the Utility or to continue to receive such service, the customer shall install at the customer's expense a visual inspection port which will allow for observation of the contents of the solids interceptor tank and extraction of test samples therefrom. Failure to provide such a visual inspection port after timely notice of not less than thirty (30) days shall be just cause for interruption of service until a visual inspection port has been installed.

2. Nonrecurring Charges

A) Sewer Service Connection (New connections only)

\$300 per SFE*

B) Plant Impact Fee (New connections only)

\$400 per SFE*

The nonrecurring charges listed above are minimum charges and apply even if the equivalency rating of a non residential customer is less than one (1). If the equivalency rating of a non residential customer is greater than one (1), then the proper charge may be obtained by multiplying the equivalency rating by the appropriate fee. These charges apply and are due at the time new service is applied for, or at the time connection to the sewer system is requested.

3. Notification, Account Set-Up and Reconnection Charges

a. Notification Fee

A fee of four dollars (\$4.00) shall be charged each customer to whom the Utility mails the notice as required by Commission Rule R. 103-535.1 prior to service being discontinued. This fee assesses a portion of the clerical and mailing costs of such notices to the customers creating the cost.

b. Customer Account Charge - for new customers only.

All Areas

\$ 13.50

A one-time fee to defray the costs of initiating service. This charge will be waived if the customer also takes water service.

c. Reconnection Charges

In addition to any other charges that may be due, a reconnection fee of two hundred fifty dollars (\$250.00) shall be due prior to the Utility reconnecting service which has been disconnected for any reason set forth in Commission Rule R.103-532.4. Where an elder valve has been previously installed, a reconnection charge of thirty-five dollars (\$35.00) shall be due. Customers who ask to be reconnected within nine months of disconnection will be charged the monthly service charge for the service period they were disconnected.

4. Billing Cycle

Recurring charges will be billed monthly, in arrears. Nonrecurring charges will be billed and collected in advance of service being provided.

5. Toxic and Pretreatment Effluent Guidelines

The Utility will not accept or treat any substance or material that has been defined by the United States Environmental Protection Agency ("EPA") or the South Carolina Department of Health and Environmental Control ("DHEC") as a toxic pollutant, hazardous waste, or hazardous substance, including pollutants falling within the provisions of 40 CFR 129.4 and 401.15. Additionally, pollutants or pollutant properties subject to 40 CFR 403.5 and 403.6 are to be processed according to the pretreatment standards applicable to such pollutants or pollutant properties, and such standards constitute the Utility's minimum pretreatment standards. Any person or entity introducing any such prohibited or untreated materials into the Company's sewer system may have service interrupted without notice until such discharges cease, and shall be liable to the Utility for all damages and costs, including reasonable attorney's fees, incurred by the Utility as a result thereof.

6. Extension of Utility Service Lines and Mains

The Utility shall have no obligation at its expense to extend its utility service lines or mains in order to permit any customer to discharge acceptable wastewater into one of its sewer systems. However, anyone or any entity which is willing to pay all costs associated with extending an appropriately sized and constructed main or utility service line from his/her/its premises to an appropriate connection point, to pay the appropriate fees and charges set forth in this rate schedule and to comply with the guidelines and standards hereof, shall not be denied service, unless treatment capacity is unavailable or unless the South Carolina Department of Health and Environmental Control or other government entity has restricted the Utility from adding for any reason additional customers to the serving sewer system.

In no event will the Utility be required to construct additional wastewater treatment capacity to serve any customer or entity without an agreement acceptable to the Utility first having been reached for the payment of all costs associated with adding wastewater treatment capacity to the affected sewer system.

- * A Single Family Equivalent (SFE) shall be determined by using the South Carolina Department of Health and Environmental Control Guidelines for Unit Contributory Loading for Domestic Wastewater Treatment Facilities -- 25 S.C. Code Ann. Regs. 61-67 Appendix A (Supp. 2003), as may be amended from time to time. Where applicable, such guidelines shall be used for determination of the appropriate monthly service and tap fee.